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Supreme Court of the United States

OCTOBER TERM, 1931.

NO. 401.

AMERICAN SURETY COMPANY OF NEW YORK,
Petitioner,

v.

THE GREEK CATHOLIC UNION.

BRIEF OF DEFENDANT IN ERROR ON QUESTIONS RAISED ON CERTIORARI.

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REFERENCE TO OPINIONS OF THE CIRCUIT COURT OF APPEALS IN THIS CASE.

This case has been before the Circuit Court of Appeals twice, and decisions have been made therein in favor of the plaintiff below, which are reported for the first Appeal in 25 Federal Reports 2nd p. 31; and the second Appeal in 51 Federal Reports 2nd p. 1050.

BRIEF FOR DEFENDANT IN ERROR.

I.

Summary of Argument.

The dispute in this suit is over the obligation, of the American Surety Company, the plaintiff in error, hereinafter called the Surety Company, to fulfill its promise to the Greek Catholic Union, the defendant in error, hereinafter called the Union, to indemnify the latter from any pecuniary loss, by reason of the defaults of George Kondor, the Treasurer of the Union.

The facts proven in the case show that said Treasurer did default, in several points, and that the Union sustained a pecuniary loss to the amount of the judgment, viz, $41,600.00, which was the interest on

$200,000.00 deposit for ~~five~~ FOUR years as required by the Agreement discussed herein, with interest amounting at the date of the verdict May 8, 1930, to $46,800.00. The Surety Company was bondsman for said Treasurer to the amount of $100,000.00, under its Fidelity Insurance Bond.

There is now no dispute that said Treasurer did actually default in his office. The testimony shows that he could not and did not account to his principal for the sums of money intrusted to him. There were other points in which said Treasurer was in default, which appear in the testimony and may be mentioned hereafter. Counsel for the Surety Company admit in their Brief of Argument, that "there is practically no dispute over the facts in this case."

There also is no doubt or dispute about the fact of the pecuniary loss sustained by the Union as the result of said Treasurer's default. The amount of such loss proven was $41,600.00, upon which interest from April 5, 1928, has accrued, and for the recovery thereof the Union brought this suit and recovered verdict and judgment therefor in the District Court, which judgment was affirmed by the Circuit Court of Appeals.

The contract of the Surety Company, on which its liability is based, was what is known as a Fidelity Bond, by which the faithfulness of said Treasurer in his office was insured to the Union. This Bond is exhibited in the evidence as Exhibit "C", and is discussed later herein.

These basal facts upon which the claim of the Surety Company's liability is founded are not now disputed.

The chief, and only real contention made by the Surety Company, has been over the effect of the con-

tract which the Union made with the United States Trust Company, for the purpose of minimizing the loss to be sustained as the result of the Treasurer's default, which action, the Surety Company contends, released it from its obligation under said Bond. The position of the Union on this point has been and is, that that action had no effect whatever to discharge the liability of the Surety Company under the circumstances, and in this position the Circuit Court of Appeals sustained the Union in both the appeals which were taken in the case.

Our argument is that that agreement was made in an emergency, at a crisis, where if it had not been made the loss to the Union would have been about $140,000.00, and the Surety Company would have had to pay its full bond of $100,000.00, but the result of said agreement was to bring the loss down to $41,600.00, which the Union had to lose by the terms of said agreement, and which the Surety Company ought to pay.

The Surety Company's bond is an Insurance Policy, to indemnify the Union against all loss by reason of defaults of the treasurer, George Kondor. Said Surety Company makes a business of writing such insurance contracts for compensation; and it was compensated in this case. Such contracts, and the rights and liabilities of the parties thereto, are governed by the rules and laws of insurance contracts, not by those of ordinary suretyship and guaranty. The case is analagous to salvage of insured goods in a burning building, where if goods are removed in an effort to save them, but nevertheless are lost not by the fire, but by other causes, the insurer is still liable for the loss.

Said agreement did not change or vary the contract between the Surety Company and the Union, to the detriment of the Surety; and the Surety was not

discharged from its obligations under said Bond. The only effect of said agreement upon the Surety was to reduce, very materially, the amount it had to pay. This we had the right to do, and, perhaps, were under obligation to do, so long as our action in so doing did not actually increase the burden of obligation on the Surety. This position has been sustained by the two decisions in the Circuit Court of Appeals in this case.

We proceed now to discuss, on behalf of the Union, these points, in the light of the evidence found in the Record of this case, and the law applicable thereto.

II.

The Surety Bond.

The surety bond upon which this case is founded is shown in the Record at pp. 35-39 as Exhibit "C". It is denominated a "Schedule Bond", and insures the Union against "such pecuniary loss as it shall have sustained" from the defaults of the officers included in the "Schedule", of whom the Treasurer, George Kondor, was one.

> (a) "through Fraud, Dishonesty, Forgery, Theft, Embezzlement, Wrongful Abstraction or Wilful Misapplication on the part of any such officer or employe, directly or through connivance with others,
>
> (b) or through the failure of any such officer or employe faithfully to perform his (or her) duties as prescribed by the Constitution and By-Laws of said Order,
>
> (c) or through the failure of any such officer or employe to keep intact and absolutely to account for all funds of the Order in accordance with said Constitution and by-laws;
>
> (d) or through the failure of any bank or trust company wherein are deposited funds for which any

such officer or employe is responsible to the Order. In case of such loss, the liability of the Surety shall not exceed the amount of the suretyship hereunder for the officer or employe directly charged with responsibility for the funds."

The amount of said bond for said Treasurer was $100,000.00. For this Bond the Surety Company was paid a premium of $500.00 annually. *This so called "Bond" is really an Insurance Policy,* in favor of the Union, insuring the fidelity of the Treasurer in his office; and the Surety Company is to be held to the obligations of an insurer, not merely of a surety.

It is well established law that, in case of a corporation which makes a business of furnishing such bonds as this, for compensation paid to it therefor, the contracts, so made, are in reality contracts of insurance, and the obligations of such bonds so issued are those of insurance policies not those of contracts of guaranty or suretyship to which the strict rules in favor of sureties are to be applied. They are contracts for indemnity, the purpose of which is to reimburse the obligees for loss and damage caused by the contingencies insured against; and so, as in case of insurance policies, the indemnitors are not relieved of obligation by the application of strict rules, but, in cases of questionable construction of the contracts, the doubts are to be resolved in favor of the assured, that he may have the benefit of the indemnity for which he contracted and paid.

The leading case on this point is, probably, *American Surety Company v. Pauly,* 170 U. S. 133, 144, in which Justice Harlan says (p. 144):

"The object of the bond in suit was to indemnify and insure the bank against loss arising from any act of fraud or dishonesty on the part of

> O'Brien in connection with his duties as cashier. * * * That object should not be defeated by any narrow interpretation of its provisions, nor by adopting a construction favorable to the company if there be another construction equally admissible, under the terms of the instrument executed for the protection of the bank."

He further mentions that the bond, as in the case of an insurance policy, was prepared and drawn up by the insurer and therefore is to be construed most strongly *against the insurer* and in *favor of the insured;* which he says is a familiar rule in the law of insurance, and "There is no sound reason why it should not be applied in this case."

Another case, between the same parties, which arose upon the bond of the president of the bank, was heard at the same time, and the same conclusions reached upon this point. It is reported in the same volume—170 U. S., p. 161.

Numerous other decisions of the Federal Courts have held the same doctrine. We cite:

U. S. Fid., etc., Co. v. Golden, etc., Brick Co., 191 U. S. 416;

Sup. Council C. K. A. v. Fid. & Cas. Co., 11 C. C. A. 96;

Tibbets v. Merc. Credit Guar. Co., 19 C. C. A. 281;

Carstairs v. Amer. Bonding Co., 54 C. C A. 85.

We quote from the opinion of Lacombe, J., in the case of *Tibbets v. Merc. Cr. & Guar. Co.*, cited above, which was a so called "credit insurance" contract or policy:

> "The cases cited by the defendant in error holding that a surety is a favorite of the law, and that

claims against him are *strictissimi juris,* have no application. Companies entering into contracts like the one at bar may call themselves 'guarantee' or 'surety' companies, but their business in all essential particulars is that of insurers who, upon careful calculation of the risks of the business, and with such restrictions of their liability as may seem to them sufficient to make it safe, undertake to assure persons against loss, in return for premiums sufficiently high to make such business commercially profitable. Their contracts are, in fact, policies of insurance, and should be treated as such."

In *Cooley's Briefs on Insurance,* Vol. 1, p. 9 *et seq.,* it is said:

"The surety company has voluntarily become what may be called a 'common surety' * * * one of those public agencies to which are given unusual powers. Since they make such regulations as seem necessary for their own protection, the stipulations will be liberally construed against them to prevent a forfeiture of the indemnity for which alone the bond is given. This seems to be the distinction between ordinary suretyship or guaranty and the contracts of these guaranty or surety companies. The ordinary surety is the favorite of the law, and the contract is construed most liberally in his favor. On the other hand, contracts of these guaranty or surety companies are regarded as contracts of common sureties doing business for a valuable consideration, under conditions fixed by themselves, and must therefore be construed most liberally against them." Many cases cited.

The case of *United States Fidelity & Guaranty Co. v. Golden Pressed Brick etc. Co.,* 191 U. S. 416, was a case certified by the Circut Court of Appeals to the Court for

decisions of two questions, one of which involved the effect upon the liability of a bonding company of the act of the insured in such a bond in giving indulgence of time to the principal of the bond, though it was not shown that any loss or damage resulted to the insurer by reason of such act of indulgence. The Bonding Company contended that it was discharged from liability under the rules of suretyship; but this Court decided the question in the negative.

The Surety Company, in its Brief of Argument in this case, cites this decision, and quotes from Justice Brown's opinion a statement about the strict rules in the case of ordinary suretyship against indulgence of the debtor by the assured, without the consent of the Surety, but does not quote the language of the actual decision, which really was that such rules do not apply to the case of a compensated surety. In connection with this citation counsel says, "In an exhaustive search he has been unable to discover any case in which the questions here presented have been adjudicated." We think that he need have only read this decision through to the end to have found the followning significant language in Justice Brown's opinion, which seems to us to decide almost flatly one important question presented in this case.

> "The rule of *strictissimi juris* is a stringent one, and is liable at times to work a practical injustice. It is one which ought not to be extended to contracts not within the reason of the rule, particularly when the bond is underwritten by a corporation which has undertaken for a profit to insure the obligee against a failure of performance on the part of the principal obligor. Such a contract should be interpreted liberally in favor of the subcontractor, with a view of furthering the beneficent object of the statute."

The decisions upon this point are collected and

digested in an exhaustive note to the case of *Hormel v. Amer. Bonding Co.* (Minn.), in 33 L. R. A. (N. S.) 513; and also in *50 Corpus Juris,* Sec. 133, pp. 80, 83, where the rules and principles above stated are set forth as established law. See also *Walker on Fidelity Bonds,* p. 31.

The law in the State of Pennsylvania is the same:

"A corporation engaged in furnishing surety bonds for a money consideration, is in law an insurance company, and must be treated as such, in determining questions regarding its liability to the obligees in such bonds."

S. Phila. State Bank v. National Surety Co., 288 Pa. 300;

Young v. American Bonding Co., 228 Pa. 373.

"In Pennsylvania, the rule of strict construction, applied to contracts of ordinary suretyship, does not prevail, where the bond or undertaking is executed upon a consideration, by a corporation organized to issue such bonds or undertakings for profit: *Young v. American Bonding Co.,* 228 Pa. 373; *Phila. v. Fidelity & Dep. Co.,* 231 Pa. 208; *Brown v. Title Ins. & Guaranty Co.,* 232 Pa. 337; *Phila. v. Ray,* 266 Pa. 345. * * * A provision in the bond itself that it 'shall be construed strictly as one of suretyship only' is unavailing, and will not prevent the surety company from being held to the liability of an insurer, *M. E. Church v. Equitable Surety Co.,* 269 Pa. 411, 415."

Our position on this point is: That the terms of this Bond are broad enough to cover all defaults of the Treasurer, whereby the Union sustained any pecuniary loss. That the rule of *strictissimi juris,* which is applied in favor of ordinary sureties, does not apply to this case; but the Surety Company is an insurer for

compensation, and must be held to that responsibility. Doubtful points are to be construed most favorably to the Union, the insured party, and all intendments made in its favor, in order that the indemnity against losses, which was the purpose of the contract, shall be made effectual, in conformity with the views of this Court expressed by Justice Harlan in the case of *Paully, supra.* This rule and the cases supporting it are not "beside the issue" in this case; but are directly in point and are decisive of the issue as the facts appear.

III.

The Treasurer's Defaults.

George Kondor, the Treasurer, whose fidelity was insured to the Union, made default in several points, about the facts of which there is now no dispute.

It is the duty of a "Treasurer" to keep safely the funds which come into his custody, and keep account thereof, and have them ready to turn over to his principal whenever properly called for. Authorities for this proposition seem hardly necessary, but we cite:

2 Abbott's Law Dictionary, Title Treasurer, p. 600;

3 Thompson on Corporations, 3 ed. secs. 1670, 1675.

And in this case the liability of the surety for defaults of the Treasurer is expressly provided for in paragraph (6) of the Bond, R. p. 36.

Mr. Kondor failed in this duty completely. There is no dispute about the fact, that when he was called upon to pay over money in his hands, on March 31, 1924, to the amount of $89,000.00, he could not, and did not produce the money. What he did in the matter merely aggravated his fault. The proven facts are that he gave

his checks for that amount,—after pressure by the other officers of the Union,—on the Peoples State Bank of Johnstown, of which he was the president, and in which he then had funds of the Union on deposit to the amount of $241,000.00; and payment was refused by the Bank for want of cash to meet the demand. Thereupon at once an investigation of said Bank was begun by the office of the Pennsylvania State Commissioner of Banking, which resulted in finding that said Bank was in such condition that it could not pay more than twenty to forty per cent. of its deposits on liquidation then, which would cause a loss of from $140,000.00 to $180,000.00 to the Union, while the Treasurer's bond was for only $100,000. See testimony of H. J. Phillips, R. 56; M. Yuhasz, Sr., R. 82.

It is now admitted that there was an actual default of the Treasurer, which entailed a great pecuniary loss to the Union, and the Surety Bond was forfeited and the Surety Company's liability accrued. As was said by Buffington, J. in his opinion in this case on the first appeal, *Greek Catholic Union v. American Surety Company,* 25 Fed. Rep. (2 Series) p. 31: "The liability of the Surety had accrued and a loss of some $140,000.00 was apparent." "The liability of the surety company became fixed when Kondor violated his official duties, and loss had accrued."

There were other defaults of said Treasurer, shown by the testimony, viz: he violated the by-laws in that he carried in his open checking account, a much larger amount than was permitted by the special provisions of the by-laws on that subject; he did not keep the funds of the Union on deposit in a "safe" bank, but the very reverse; he kept all said funds in the bank of which he was president, with a capital of only $50,000.00, and which he knew was unsafe for such large deposits as he

made for the Union; he did not fulfill his duties about paying out moneys appropriated to be paid on Mortuary Accounts, but retained the checks sent him by the President and Financial Secretary for that purpose, thereby holding funds in said Bank which he should have paid out. Testimony of Phillips, R. 61 and 64; Jendricks, R. 73; Kourlos, R. 105. By-laws, Art. 7, Sec. 32 (4), R. p. 32.

The facts with respect to all these defaults are fully shown in the evidence, and was submitted to the jury on the trial by Judge Gibson in a full and fair charge, see Record, pp. 185-195; and the verdict of the jury was for the plaintiff below the Greek Catholic Union, and there is no dispute about them now.

IV.

The Agreement Made By the Union With the U. S. Trust Company, for Minimizing Loss.

The chief stress of the Surety Company's defense in this case is laid upon the fact that this agreement was made, and, as it alleges, varies its obligation under said surety bond and substitutes a new risk to its prejudice. *This contention is not true.*

The facts about the making of this agreement, as shown in the Record, are as follows:

When the Supreme Officers of the Union learned that the checks for $89,000.00 which they had drawn, and which the Treasurer had signed, to be used in payment for certain investments which they had agreed to make, would not be paid, because the Peoples State Bank, in which the funds of the Union to an amount of $241,000.00 or more were deposited, had not the money available to pay them, they, said Supreme Officers, at once arranged for a meeting of the Supreme Assembly

of the Union, which is the Board of Directors of the corporation, to be held and have the situation of said Bank and the Treasurer's accounts investigated.

That meeting took place at Johnstown, Pa., on Friday afternoon, April 4, 1924. The Union Officers went to the Peoples State Bank at that time and found the representatives of the Pennsylvania State Banking Commissioner examining the books, etc., of the Bank, said examination having been called for by the officers of said Bank, without the knowledge of the Union. Mr. Graff, the Deputy State Banking Commissioner, told Mr. Yuhasz, the president of the Union, not to present those checks, or he would have to close the bank; but he was trying to arrange with some other bank in Johnstown to take over the Peoples State Bank, to save the situation. Testimony of Graff, Rec. p. 61 and Yuhasz, Rec. pp. 81-82.

The examination of the bank's affairs, and the negotiations with officers of other banks went on during the next day and night, Saturday, April 5th, the officers of the Union also participating in the examination. No satisfactory result was reached that day nor evening. Sunday morning at about 2 o'clock A. M., Mr. Ralph Davis, of counsel for the Union, communicated by telephone from Johnstown, with Mr. Benham, a vice president of the Surety Company at Pittsburgh, who had executed this Bond for the Company, and informed him of the situation at Johnstown. The situation as far as it had then developed, and as Mr. Davis told Mr. Benham, was that the Peoples Bank could not pay said Treasurer's checks, and that the Banking Commissioner would not allow the bank to open on Monday morning unless arrangements were made to have a deposit of $100,000.00 made by either the Union or the Surety Company, before that time; or arrangements were made to have the bank taken over by a solvent bank, negotia-

tions for which were pending but not so far successful; and it was added that a representative of the Surety Company should attend there at once, which would not have been impossible.

Mr. Benham disclaimed authority to act for the Surety Company in such a case, and referred Mr. Davis to Mr. McGinn in New York, the officer of the Surety Company in charge of claims. Mr. Davis got Mr. McGinn by telephone at his residence in New York about 10 o'clock A. M. of that same day; but he disclaimed authority to act individually for the Surety Company in such a case. So the officers of the Union were left to act alone in the situation without help of advice from the Surety Company (R. p. 94).

It is incorrect to argue, as is done in our opponents' Brief, that Judge Buffington was misled by the form of the allegation in the Statement of Claim, into error in the language he used in the first decision of this case by the Circuit Court of Appeals, and that said error was perpetuated in the trial, and on the second appeal. There was no error. When the Judge said that "the insurer, with knowledge of the loss, left the insured to meet the situation alone", that was true. The *loss* had accrued when it was known that the treasurer had made default, and of that fact, and of the fact that it then appeared that said loss would very greatly exceed the amount of the surety's bond, Mr. Davis' conversation with Vice President Benham and Claim Adjuster McGinn fully apprised the Surety Company. What Mr. Davis did not attempt to tell them was just how great the loss would be; nor did he tell them of the proposition of the United States Trust Company to take over the Peoples' Bank, for that proposition had not then been made. It is true that these officers of the Surety Company declined to do anything at that time,

and so the Union was left to take care of the situation without aid or counsel from the Surety Company. And when, early Monday morning the proposition for the agreement with the Trust Company was developed, the officers of the Union had to act upon it themselves without further consultation with the Surety Company.

The negotiations with Johnstown Banks, continued however during Sunday, April 6th, and before midnight of that day, the United States Trust Company of Johnstown, an institution satisfactory to the Banking Commissioner, and to the others present and concerned, made a proposal to take over said Peoples State Bank, and pay its depositors in full upon the condition that the Union would leave $200,000.00 of its deposit stand with said Trust Company, without interest, for four years. This proposal was discussed during that day and night, and was finally agreed to and a written agreement was prepared, and submitted to the Board of Trustees of the Union, a quorum of whom had remained in Johnstown and were called together for action. See Testimony of M. Yuhasz, Sr., pages 83-93, and John Macey, page 97 of Record. A copy of this written agreement is shown as Exhibit "F" at page 179 of the Record. As executed it contains the provision that the Union should keep a deposit of $200,000.00 with the Trust Company, without interest for four years; which was an essential condition upon which said Trust Company agreed to enter into the contract. Testimony of Phillips, Record p. 59.

If this agreement had not been assented to, the Bank would not have opened the next morning, but would have been in the hands of the State Banking Commissioner for liquidation.

The examination of the Peoples State Bank's books and assets made by the Bank Examiners, and concurred in by the Auditors of the Union, as above stated showed

that if said bank should be forced into liquidation, by the Banking Commissioner, through a receiver in the usual way, it would pay only from twenty (20) to forty (40) per cent. of the deposits. Testimony of M. Yuhasz Record, page 82; Phillips, Record, pages 53-56.

These facts, with respect to the making of this agreement, clearly show that the officers of the Union were acting in a vital emergency, and that they had to decide and act without any aid or advice from the Surety Company; also that their object in the action they took was to save loss, both for the Union and for the Surety Company, and that their action did in fact so operate, as much or more for the advantage of the surety as for that of the Union.

As we have said above, this surety bond, is in fact and in law an insurance policy; and the rights and obligations of the parties are to be judged and applied as in case of such a policy; the Union being the insured, and the Surety Company being the insurer.

V.

A Case of Salvage By the Insured.

The situation at Johnstown on April 5th to 9th, 1924, was analogus to that of a burning building in which insured property was kept. In such case the insured owner of the goods must use all reasonable efforts to remove them to a place of safety. Generally, he is so required by the express terms of the insurance policy, but without such express requirement, it is his reasonable duty to do so, and minimize the loss of the insurer to such degree as is practicable in the case. He is not penalized for his efforts in trying to save what can be saved from the loss, by withholding from him the right to recover anything on his policy. The insurer gets the benefit of the well intentioned efforts of the insured, and

gets credit on the policy for the value of the salvaged property, but is always liable for what loss remains after that credit is given.

We cannot cite any case in which an insurer undertook to avoid the whole policy because the insured endeavored to minimize the loss by efforts at salvage. Probably no such case ever occurred. But it is well settled law, in fire insurance cases, that such action for salvage taken by the insured is proper. And where goods thus in good faith attempted to be saved have been damaged, lost or stolen, without fault of the insured, in the process of such attempts at salvage, such losses are held to be within the coverage of the policy, for which the insurer must pay. If no effort to save the goods had been made they would have been lost. The fact that the well-meant efforts of the insured to save them were not successful, because they were eventually lost, though not by the fire directly, does not relieve the insurer from liability for them as included in the loss insured against.

> "If it became necessary to remove the goods in order to prevent their destruction by fire, and if in consequence of the measure thus taken, some of the goods were lost or destroyed, although by theft, the insurers will be answerable for the loss, *because it is a sacrifice for their benefit.*" (Italics are ours.)

Instruction by Hare, J.—affirmed by Supreme Court in: *Insurance Co. v. Agnew,* 34 Pa. 96.

See also:

Lukens v. Insurance Co., 25 Legal Int. 61;
Insurance Co. v. Cuff, 35 L. R. A. (N. S.) 892, and cases cited in note;
Insurance Co. v. Patterson Drug Co., L. R. A. 1917 D. 1091.

An insurance company is liable, under a fire policy, for goods lost while in process of removal from a building on fire. This is true with respect to goods in a building endangered and to some extent damaged, though the goods would have neither been burned nor injured had they been left in the building.

4 Cooley's Briefs on Ins. 3065.

So also is there analogy with the case in marine insurance where the master of a vessel in peril may jettison cargo in order to save the ship. If such cargo is insured, the insurance is not forfeited by this fact.

2 Arnold Marine Insurance, Secs. 908 et seq.

According to the rules established by the cases which we have cited above, the "bond" in this case is to be considered as a policy of insurance and the liability of the Surety Company is to be determined by the rules and principles applicable to insurance contracts. Applying these rules and principles to this case, the loss of interest on the impounded deposit of $200,000.00 is clearly a sacrifice made to prevent the much greater loss which would have occurred if that agreement had not been made, and the insurer has the benefit thereof, and is liable to reimburse the plaintiff.

VI.

The Effect of the Agreement on the Surety Company's Liability.

The Surety Company, at the trial, took the position that the Union, by entering into that agreement had greatly prejudiced its rights as surety on said Bond.

That position of the Surety Company was set forth in its Fourth Request for Instructions, which the Court below refused, and which is now urged as an Assignment of Error. That point is shown on page 203 of the Record, and is as follows:

"4. The agreement between the plaintiff Union and the States Trust Company of Johnstown having effected material variance in the defendant's contract of suretyship and having permitted the affairs of Peoples State Bank to be liquidated and its assets collected by said Trust Company instead of a Receiver to be appointed by the Banking Department of the State of Pennsylvania, removed from defendant Surety Company all possibility of participation in any salvage therefrom, and of proving said variance to have been prejudicial and said defendant is thereby relieved of the burden of showing that said variance was prejudicial to it."

That point was rightly refused and there was no error of law in that ruling.

This Bond is *an Indemnity Insurance Contract.* It is true that if in such a contract the insured agrees to a material variance of the terms of the contract or relationship between him and the party whose fidelity is insured to the prejudice of the insurer, the latter may be thereby relieved of its obligation. But such relief is very narrowly limited to cases where there is truly such a variance, and it is actually material, and is or will be actually prejudicial to the insurer's rights and interests.

The contract with the U. S. Trust Company did not alter or vary the terms of the Surety Bond in any way whatever. There was no agreement with the Treasurer, altering his position in the case; there was no agreement made under which the Surety Company was made liable for anything for which it was not already liable. Upon the failure of the Peoples Bank to honor the Treasurer's checks his bond was breached, and the fact, but not the precise amount of the Surety's liability was likewise then fixed. The agreement with the Trust Company had nothing to do with those features of the case. *What*

it had to do with, and was intended for, was the ascertainment of the amount of the loss which must be sustained by the Union as the result of the Treasurer's default. The purpose of it was to minimize that loss, for the benefit both of the Union and the Surety, and it did so operate in fact.

There was no variation of the contract in this case. But even if there be a variation of such a contract, that fact does not relieve the insurer of his obligations, unless he was injured or prejudiced thereby. The law of Pennsylvania is clear on this point.

> "A corporation engaged in the business of suretyship for profit cannot successfully defend merely because of a change in the contract insured; it *must prove* that the change was material, and prejudicial."
>
> *Phila. v. Ray,* 266 Pa. 345.

Those words were quoted with approval in *Sokoloff v. Fidelity & Cas. Co.,* 288 Pa. 211, 215. The same rule was applied in *Conroy v. Commercial Cas. Ins. Co.,* 292 Pa. 219, 228.

A similar rule prevails in the Federal Courts,

> "In contract of this kind," (indemnity insurance) "to escape liability, *the insurer must show,* that the breach is something more than a mere technical departure from the letter of the bond—that it is a departure which results in *substantial prejudice and injury* to its position in the matter.
>
> *Parmelee v. Aetna Life Ins. Co.,* 166 Fed. 741.

The case of *St. Louis Dressed Beef Co. v. Maryland Casualty Company,* 201 U. S. 173, is a case of a bond given for indemnity against loss and damage by reason of negligence of the employees and vehicles of the in-

sured in total amount of $10,000.00. In the operation of one of the insured vehicles a woman was run down and very seriously injured. The Insurance Company being notified of the facts refused to recognize its liability, (on grounds which it was decided were not tenable). Suit was brought by the injured woman for $10,000 damage and by her husband for $3000 damage. The Insurance Company being notified to defend this suit refused to do so. The insured made what was considered a very favorable compromise with the plaintiffs for an amount of $2500 in all, for the damages for both, and brought suit against the Surety Company for that amount. This suit came to the Supreme Court by certificate from the Circuit Court of Appeals, and the Supreme Court decided that the plaintiffs should recover, saying *inter alia,* that "a sum paid in the prudent settlement of a suit is paid under the compulsion of the suit just as truly as if it were paid upon execution;"—though the bond and policy in this case provided specifically that "no settlement should be made by the insured without consent of the surety, nor any suit brought to recover any loss, except loss actually sustained and paid in satisfaction of a judgment after trial, etc."

For the Union we contend that there was in this case no variation or departure from the terms of the original contract. The Surety Company's contract was to insure the fidelity of George Kondor as treasurer, and to make good to the plaintiff loss which it might sustain by reason of his defaults in that office. He defaulted, loss was sustained, and it is for that, that we are suing in this suit.

The fact that the amount of the Union's loss is affected by a later agreement made with another party for the purpose of minimizing that loss, constitutes no variation or departure from the original contract on the

bond. The bond contains no stipulations as to how the loss which might occur should be ascertained or computed.

If the defendant, the Surety Company, had shown that the agreement made with the United States Trust Company for the purpose of minimizing the loss in the case was harmful to it and, now that it is all over, has resulted in loss that it would not otherwise sustain, it might bring itself within the limitations of the rule in question, but it has done nothing of the kind. It offered no evidence directed toward that issue. All the evidence in the case shows that it, the Surety Company, was substantially benefited by the arrangement. Its loss was minimized to an extent even greater than was that of the plaintiff, which was the amount claimed in this suit.

On the contrary, under the facts presented and proven to the jury, the agreement entered into resulted in a saving to the Surety Company. See Plaintiff's Exhibit "E" (R. p. 177) and testimony of E. R. Cherry (R. p. 69), being a statement showing the condition of the Peoples State Bank at the time of closing, which shows in round numbers that the frozen assets, to wit, loans and discounts, bonds, real estate, furniture and fixtures, and deficit, those which were not quickly collectible, amounted to $399,000, and the cash and quick assets amounted to $98,000. The depoits amounted to $403,800. The capital stock, surplus, undivided profits, etc., amounted to $82,000. Upon immediate liquidation of the Peoples State Bank on April 7, 1924, by the distribution of the quick assets to depositors, that is $98,000 cash and quick assets to $403,800 worth of deposits, there would have been then a 24% dividend, the time for the payment of which would be indefinite. The Union would have received 24% of its $241,000 deposits or

$57,840. If the Surety Company had paid its $100,000 bond, the Union would then have received $157,840, or a loss to it of $83,160, and to the Surety Company of $100,000, but that was not done. What was done was liquidation by the United States Trust Company under the Agreement, which at the end of four years, the period for which interest lost under the Agreement is claimed, was shown to have resulted as follows: There was collected from the assets the sum of $259,000 or 64% of its liabilities. This would have meant a dividend to the Union of $154,240 (64% of its deposit of $241,000). If the Surety Company had paid the $100,000 bond at the beginning, so as to entitle it, according to the terms of the bond, to share proportionately with the Union in the distribution, then to be made, it would have received 100/241 of this dividend or $64,000 as its share of the distribution. In the meantime it would have lost the interest on the $100,000 payment for four years, which amounts to $24,000, so that its total loss would have been $60,000. Perhaps, some dividends would have been declared in the meantime, effecting payment of a portion of the $64,000 before the expiration of four years, which would have reduced the interest; but had this liquidation been in the hands of a Receiver for the State Banking Department, the only alternative if the Agreement had not been made, there would have also been paid the Receiver's fees, costs and expenses of the operation, which would have reduced the amount for distribution at least as much as to balance the credit on account of interest. Thus by operation of the Agreement the Surety Company's liability is reduced to only $41,600, the amount of the Union's claim, whereas under the most favorable liquidation proceedings extending over a period of four years, its loss would have been in round numbers $60,000.

These figures are taken from Exhibit "E" (Record p. 177), and testimony of the witnesses presented to the jury by the Union. No evidence relating to or bearing upon this question was presented by the Surety Company. All these facts, together with such others as were in the possession of the United States Trust Company or the State Banking Department of the Commonwealth of Pennsylvania, could have been secured and presented by the defendant if it had assumed the burden which the law placed upon it of showing that the original agreement worked to its prejudice. It is a matter of common knowledge that a forced liquidation by a receiver appointed by the court under the jurisdiction of the State Banking Department would not have resulted in the collection of as large a part of the assets of the Peoples State Bank as would be and were received from the liquidation by a local bank over a period of time without court costs, receiver's fees and other expenses.

The burden was on the Surety Company to show that it had actually sustained prejudice by the making and carrying out of said agreement with the Trust Company; but it showed no such loss or prejudice and it made no effort to do so. It offered no testimony on that point, and the only testimony was that from the Union's witnesses on the trial of the case, by which it is shown after four years that the liquidation as conducted really saved the Surety Company a large sum of money, and that it would have had to pay much more than the amount for which this judgment calls; unless the State Banking Department had been much more successful in liquidation than the Trust Company was, of which there is no evidence and no probability.

As above stated there was no change in the contract between either the Union and the Surety Company, or

between the Union and George Kondor, the principal on the bond, and the burden is heavy upon the Surety Company to show that the agreement so made and carried out caused it material damage or prejudice. The testimony of the Union, which was put in for the purpose of furnishing the jury with all of the facts, resulting from this unfortunate situation, should be construed in favor of the Union and the failure of the Surety Company to present any facts or to cross-examine the witnesses as to these facts can be readily presumed to show that the defendant could not have produced any facts in its favor.

The only answer which the Surety Company makes to this argument is that the contract made with the U. S. Trust Company varied the terms of the original contract upon which it had given its bond, because it prevented the Surety Company from having any opportunity to exercise the right of subrogation, and to show that on proper liquidation of said Bank its loss would not have been much as it is under this judgment.

This argument is fallacious. The only alternative to the making of this agreement was that the Pennsylvania State Banking Commissioner would take over the defaulting bank, close it and place it in process of forced liquidation in the usual method in such cases, that is, by a receiver appointed by the Banking Commissioner. The Surety Company would have had no chance whatever to get the assets of the defaulting bank in its control for liquidation, unless, perhaps, it had been willing to give security satisfactory to the Banking Commissioner that all the obligations of the defaulting bank to its depositors, and also to its stockholders, would be paid in full. The Banking Commissioner could not have permitted a third party to take the assets of the defaulting bank out of his control on any other terms, and there is no likelihood that the Surety Company would have made any

such terms; consequently, if the agreement had not been made, the liquidation of the assets of the Peoples State Bank would have been conducted in the ordinary form of a receiver under the State Banking Commissioner, and the experience of such liquidations has always been that the loss to the depositors and others would be greater than where the liquidation was conducted, as it was, in the present case, by a friendly bank in the immediate neighborhood and well acquainted with the whole situation.

VII.

Fallacy of Argument of the Surety Company Under the Facts of the Case.

The argument advanced by the Surety Company to the effect that if this judgment should be affirmed and become the law of the land, the effect would be very injurious to the business of writing surety bonds, requiring all companies engaged in that business to revise their calculations, on which their schedules of premiums have been arranged, and require higher premiums to be charged for such insurance than have been prevailing, is not sound in this case. *There is no foundation for it in the facts of the case.* It is based purely on assertions of which *no proof of the truth has been offered.* There is not a word of testimony to show upon what calculations the premium charged for this bond was based. Nothing to show that the Surety Company did not include such risks as this in its calculations. The Court is asked to assume that such is the case upon the mere assertion of counsel, which is too violent an assumption to be made in the circumstances of the case. The argument is one *ab inconvenienti*, which at its best is a weak form of argument; for it asks the Court to decide against the logical conclusions of existing law, and the manifest

justice and equity of the claim in this case, *because,* as it says, great inconvenience would result to the business of bonded suretyship,—without a line or word of proof that the assertion is true, for this Company in this case, or for any other company in any case. If such harm will be done by this decision, the proposition was surely capable of some sort of proof, but none has been offered.

On the other hand the proof clearly shows that this was no other risk than that originally assumed by the Surety Company, viz., to indemnify the Union from any loss, excepting only one sustained by a material variance of the terms of its Bond actually prejudicial to the Surety. As a matter of fact, and fully developed by the testimony in this case, no new additional risk was imposed upon the Surety Company by the agreement made by the Union in this case; none is or will be placed upon it, nor could any such increased burden of risk be imposed by applying the principles and affirming the conclusion of this argument, to wit, the right of the insured to make an agreement to minimize the loss after it has accrued. Rather, in this instance, *the Surety Company, is clearly shown to have had its liability reduced, and in all probability its risk lessened.*

It is true that the agreement prevented a closing of the Peoples Bank by the State Banking Commissioner and a liquidation by a Receiver. If that procedure is a right which the Surety Company thinks it is entitled to assert under its contract, then it must be admitted that it was deprived thereof, and deprived of opportunity to show how much it might have gained by that procedure. But the facts show how utterly futile such procedure would have been for the Surety Company. It is common knowledge that liquidation in that way is not *economical;* and the Union has produced the facts clearly showing that the liquidation under the agreement was de-

cidedly to the advantage of the Surety Company. In other words, the proceedings under the agreement as we have shown them, were as good as could be expected in such a situation as is now disclosed by the evidence in this case, and the Surety Company was saved a large sum of money by the operation. It is idle to argue that it was deprived of a right to have subrogation so as to make claim against funds in the hands of a receiver, when it appears that by the operation of the agreement it got greater benefit by the definite fixing of its loss, than it could hope to get from such a receivership.

The facts regarding the actual liquidation of this bank were just as accessible to the Surety Company as to the Union. The Union was able to prove them; and that being so how can the Surety Company now argue that it was deprived by said Agreement of any opportunity to show that the loss sustained by it would have been less than it was? It had full opportunity to produce all the facts on that subject, but made no effort to do so, *because those facts were against its claim,* as we have shown.

The Union's contention is that by this Bond it was contracted to be indemnified against all loss by the defaults of the treasurer, and that it had a right,—perhaps an obligation—to do anything practicable to reduce such loss; provided its action did not cause greater loss to the Surety than would have occurred otherwise. It has shown the facts, which clearly prove that what it did was beneficial to the Surety, not harmful, in any sense. The burden of proof is on the Surety in such a case to show that the acts of the insured were prejudicial to it, which it did not do in this case; *but the Union did prove the contrary;* and the Surety Company is now in the position of contending that although it was largely benefited by the Agreement, as it was intended it should

be,—yet on a *mere technicality* it should be held to be discharged of all its obligations under the bond. In other words the rule of *strictissimi juris* would be invoked in its favor, though the law has been established by the decisions of this Court and other Courts of the States, that that rule does not apply to a compensated surety, who makes a business of such bonds.

In all fairness and equity, the Surety Company should not be permitted to escape its liability under this bond to the amount charged against it in this suit, whereby it is manifest that *it has been saved the difference between $100,000.00 and $41,600.00 under its paid fidelity insurance bond,* by which it obliged itself to indemnify the Union against all loss or damage resulting from the acts of said Treasurer, George Kondor.

VIII.

Conclusion.

The Surety Company, plaintiff in error, bases its appeal on three assignments of error which raise the questions considered in this argument.

The first assignment is that there was error in not granting a request by the Surety Company for binding instructions in its favor. This is a request for binding instructions and was properly refused. The defaults of the Treasurer were based upon facts which were disputed by him and the appellant. Such had to be left to a jury; they were submitted to it by the Court and the jury resolved them in favor of the plaintiff below. The facts leading to and upon which the agreement were entered into were for the jury. Because the Surety Company failed to produce any facts for submission to the jury, which might have shown prejudice to it in the signing of the agreement, could not prevent the jury

from passing upon the facts submitted to it by the plaintiff. In addition the credibility of the witnesses was for the jury. The Court as a matter of law could not have withdrawn the case from the jury or have given binding instructions.

The second assignment is that the Circuit Court of Appeals erred in refusing to find and hold that the material variance of the risk insured by appellant, whereby a new hazard not covered by the bond was sought to be imposed upon the appellant and it was deprived of opportunity both for subrogation and for obtaining proof that the variance was prejudicial, constituted a full defense to the claim against the surety. This assignment, as it is stated, assumes that the contract made by the Union with the United States Trust Company was a material variance of the contract of insurance in this case, *which assumption is erroneous,* as we have argued heretofore in Section VI of this Brief.

This assignment is further explained by the third assignment which repeats the assignments of error relied upon by the Surety Company in the Circuit Court of Appeals and alleges there was error in the Circuit Court of Appeals in not sustaining its position, and this particular point of the material variance of the agreement made with the United States Trust Company is contained in the fourth request of the Surety for instructions to the jury at the trial, which the trial court refused, and which we have discussed at the beginning of our Section VI; and it is also embraced in the Union's eighth point, R. 202, for instructions to the jury at the trial which the trial court below affirmed.

Under the law, the Surety Company had the right to prove, if it could, that the variance alleged was prejudicial to it. The Court as a matter of law could not charge that the agreement removed all possibility of

proving it to have been prejudicial to the Surety Company. His Honor, Judge Wooley, in referring to an "issue of prejudice" undoubtedly referred to the legal liability resting upon the Surety Company to sustain an allegation of such "prejudice" when it is in issue. Of course, the Surety Company could not, nor could any one else, show by testimony what would have been the result had the Commissioner of Banking taken over the Peoples State Bank; appointed a receiver according to law, with the attendant receiver's and attorney's fees, court costs and other costs and expenses. Yet there was nothing to prevent the Surety Company from proving what actually did happen. It could have produced, by subpoena, if necessary, all the books and records of the Peoples State Bank, the books and records of the United States Trust Company the records of the Banking Commissioner of the Commonwealth of Pennsylvania, and from them have shown exactly what became of the assets of the Peoples State Bank and what amount of salvage was recovered from these assets by the United States Trust Company. From those records and facts, it could have shown wherein this agreement was prejudicial to it, if such were a fact. The Surety Company produced no such available testimony and it is therefore fair to presume as true, that the assets of the Peoples State Bank as actually collected by the United States Trust Company, without receiver's or attorney's fees, court costs or other costs and expenses, were insufficient, if distributed as salvage among the parties that would have been entitled thereto, to have reimbursed the Surety under its right of subrogation in a sum which would have saved it as much as did the agreement entered into. The records relied upon by the plaintiff to show the situation to the court and jury were presented and the Surety Company had the same right to the use of the records. If those records had shown that the agreement deprived the Surety Company of a large

amount of salvage secured from the assets of the Peoples Trust Company such, if believed by the Court and jury, would have entitled it to a verdict in its favor.

The Surety Company refused to produce such testimony, because such was not the fact, and requested the Court to charge that, because its right of subrogation was taken away, it was relieved of liability, whether the action of the Union was either beneficial or prejudicial to it.

This is almost exactly the same question submitted to the Court in the case of *U. S. Fid. etc. Co. v. Golden Brick Co.*, 191 U. S. 416, and the Supreme Court answered the question in the negative. Therefore, the Court properly refused the point.

The assignments of error are not sustained by the record and this appeal, therefore, should be dismissed.

Respectfully submitted,

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